Even in Rhode Island, money can't buy love

By TOM SGOUROS

We learned last week that Operation Dollar Bill, the federal investigation of the Senate leadership, involves tax legislation. In federal court, Gerard Martineau, the former Senate Majority Leader from Woonsocket, admitted to crimes involving taking money from CVS in exchange for legislative favors. In cases involving other former senators, we've already heard about corruption involving "pharmacy choice" legislation, where the legislature rejected bills that would have allowed pharmacies to compete with each other for your business. But now we hear that some of the favors may have involved the 2002 capital gains tax cut. If it's true that money changed hands in order to influence tax legislation, I have some free advice for the CVS and Blue Cross executives who gave it: Don't waste your money. Most of the legislators in our General Assembly love you already, and money can't buy that kind of love.

Here's the background. In the 1990s, Massachusetts eliminated its tax on long-term capital gains, the money you earn from the sale of some asset, like stocks or a business, so long as it was held for more than six years. And in 2000, the drum began to beat here for a change to "compete" with Massachusetts. Martineau was an enthusiastic drum-beater, doing as much as anyone to speed this along.

In 2002, the General Assembly eliminated the tax on long-term gains, though the first step didn't go into effect until this year (and because of the budget crisis this past spring, the legislature delayed the second step). Putting cuts off into the future is, of course, the usual way faint-hearted legislators avoid questions about what services will be eliminated to pay for them. But while eager investors waited for the cut to take effect, what happened in Massachusetts? Well, they had their own budget crisis in 2002, so they reinstated the capital gains tax, acknowledging that cutting it was not affordable.

You'd think that we could have used that excuse to put off our cut, but no. After all, love is an ever-fixed mark that looks on tempests and is never shaken, or so I've heard, and legislators remain in love. They appear locked into the view that investors drive the economy and making things nice for investors will make the economy better for all the rest of us. But where's the evidence for that? Investors who start or grow businesses are valuable, but they're only a part of the puzzle, along with inventors, workers and customers. Sacrificing the interests of these other groups to favor investors is what we're doing.

What's worse, most investors aren't even investing in local businesses. The Federal Reserve publishes statistics about this, and the September report (the "Flow of Funds", or "Z.1" report) has interesting things to say on the point. Nationally, about 10 percent of our assets are in non-corporate businesses and 20 percent in stocks and bonds. A generation ago, in 1974, 20 percent of our assets were businesses and only 14 percent in stocks and bonds. As the profitability of small businesses has declined, our taste for investments has changed, and investors today are much more likely to be speculating in the stock market or in real estate than they are to be growing businesses here at home.

Stocks and bonds are traded much more often, too. Again according to the Fed, we sold around ten times as much in stocks as in business shares so far this year. This means that for every person getting a tax break on the sale of some business they built, 10 people are getting a tax break on some stock they bought. And who are these people? According to IRS statistics, in 2005, Rhode Islanders reported about $1.7 billion in capital gains income. About $1.3 billion of that was reported by people who earned more than $200,000 that year, a fifth of that group's income.

Every small business owner I've talked to in the past few years has told me the same story about how their business started: The money to start was scraped together through savings and from family and close friends. These people will eventually sell their businesses in order to retire or move on, and they may be wealthy when they do. Perhaps it would be nice to reward them for their hard work at that point, but wouldn't it be nicer to make their businesses more profitable before then?

We could invest in our schools in order to make it easier for them to find good employees. We could create a health care system that takes health insurance out of the picture for employers. Some will perceive this as a two-edged sword, but we could work to create more and better customers for businesses by raising the wages of our lowest-paid workers, which seriously lag Connecticut and Massachusetts. There are dozens of things we could try, if we had the imagination to try them. The capital gains tax cuts will only prevent us from trying them.

Many of our legislators own small businesses themselves (Gerard Martineau among them — it was purchases of bags from his company that CVS used to finance his legislative career). Most of them know how businesses really get their start, but rather than think about the real problems faced by real businesses, our legislative leadership thinks that the route to prosperity is simply to roll out the red carpet to all rich people, and hope that some of them feel charitable toward the state they call home.

This is love run amok, and more resembles a strategy for finding a bad marriage than a strategy for developing our state's economy.

It's long past time we wised up.

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